TERRY ALLEN PERL
PRESIDENT
CHIEF EXECUTIVE OFFICER

February 4, 2005

VIA EMAIL (rulecomments@jwod.org) and
VIA FACSIMILE (703) 603-0655

The Committee for Purchase From People
Who Are Blind or Severely Disabled
ATTN: G. John Heyer, Esq.
1421 Jefferson Davis Highway
Jefferson Plaza 2 Suite 10800
Arlington, VA 22202-3259

RE: The Chimes' Comments Concerning the Committee for Purchase's Proposed Self-Governance Rule, 69 Fed. Reg. 65,39

Dear Mr. Heyer:

The Chimes, Inc. ("Chimes") hereby submits its comments concerning the proposed rule relating to governance standards and executive compensation in the Javits-Wagner-O'Day ("JWOD") program published by the Committee For Purchase From People Who Are Blind or Severely Disabled (the "Committee") on November 12, 2004 (69 Fed. Reg. 65395).[1] Chimes is a nonprofit organization serving disabled persons across the U.S. and overseas, and has been a participant in the JWOD program since 1994. Chimes employs some 1557 disabled persons. Chimes is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended.

[1] Chimes hereby incorporates by reference the comments it filed on December 10, 2004 concerning the paperwork burden associated with the proposed rule. Chimes wishes to make one correction to that filing. In that filing we indicated that the maximum time for submission of Form 990 was 11.5 months, it is in fact 10.5 months.

(A) A. Proposed Regulation 41 C.F.R. § 51-2.10(b) Exceeds the Committee's Statutory Authority

Under the proposed regulation, the Committee will regulate executive compensation paid by a JWOD nonprofit organization. It will determine whether the compensation is reasonable by application of a benchmark maximum amount. If the Committee determines that the compensation is unreasonable, then a nonprofit organization can lose its eligibility to participate in the JWOD program.[2] Nonprofits applying to the program for the first time would be denied entry. Under the proposed regulation, an existing JWOD agency paying compensation that the Committee determines to be unreasonable would be treated as a "violation" of the regulations.[3]

In determining whether an administrative agency exceeds its statutory authority in issuing regulations, courts consider whether Congress has spoken directly to the precise question at issue by looking to the particular statutory language as well as the language and design of the statute as whole, and intent of Congress is given effect, if intent is clear. *Chemical Mfrs. Ass'n v. U.S. E.P.A.*, C.A.D.C.1990, 919 F.2d 158, 287 U.S. App. D.C. 49. The JWOD statute is very clear in terms of the eligibility criteria for the program. There simply is no Committee authority to regulate the salaries paid to nonprofit executive employees or to change the JWOD eligibility criteria established by Congress in the statute.[4]

The JWOD Act does not authorize the Committee to regulate executive salaries of JWOD nonprofits. Under 41 U.S.C. § 47(a), the Committee has the powers to establish, add to, and remove commodities and services on the procurement list; (b) determine the fair market price of commodities and services on the procurement list;

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[2] The regulation is unclear as to what would happen to existing JWOD contracts.

[3] Even though a determination that compensation is unreasonable is treated as a violation, there is no provision made for grandfathering existing JWODs. Current compensation would have to be reduced in order to avoid a finding of a violation of the regulations.

[4] The wages of hourly service employees are regulated by another statute – the Service Contract Act, 29 U.S.C. § 351 *et seq.*

and (c) designate central nonprofit agencies. 41 U.S.C. § 47(d)[5] also authorizes the Committee to make rules and regulations for: (a) specifications for commodities and services on the procurement list; (b) the time of their delivery, and (c) such other matters as may be necessary to carry out the purposes of sections 46 to 48c of this title." However, nothing in those referenced sections mentions compensation for services rendered by executives of nonprofits.[6]

In 41 U.S.C. § 48(b), Congress defined "qualified nonprofit agencies" with a high degree of specificity. Congress provided that a "qualified nonprofit agency for other severely handicapped" means an agency:

(A) "organized under the laws of the United States or of any State, operated in the interest of severely handicapped individuals who are not blind, and the net income of which does not inure in whole or in part to the benefit of any shareholder or other individual;"

(B) which complies with any applicable occupational health and safety standard prescribed by the Secretary of Labor; and

(C) which in the production of commodities and in the provision of services (whether or not the commodities or services are procured under sections 46 to 48c of this title) during the fiscal year employs blind or other severely handicapped individuals for not less than 75 per centum of the

[5] 41 U.S.C. § 47(d) reads, in full:

(d) Rules and regulations; blind-made products, priority

(1) The Committee may make rules and regulations regarding (A) specifications for commodities and services on the procurement list, (B) the time of their delivery, and (C) such other matters as may be necessary to carry out the purposes of sections 46 to 48c of this title.

[(2) provides that the Committee shall prescribe regulations so that procurement list commodities and services receive priority in Government purchases.]

[6] Specifically, 41 U.S.C. § 46 deals solely with the establishment, membership, and structure of the Committee. 41 U.S.C. § 48 states that agencies of the government are bound to purchase commodities and services under the Act unless exempted. 41 U.S.C. § 48(a) describes auditing procedures. 41 U.S.C. § 48(b) contains the definitions. 41 U.S.C. § 48(c) authorizes annual appropriations for the Committee.

> man-hours of direct labor required for the production or provision of the commodities or services.

The language in the definition concerning inurement to private individuals is virtually identical to language contained in Sections 501(c)(3) and 501(c)(4) of the Internal Revenue Code, and is similar to the language contained in many state nonprofit corporation acts.[7] (Indeed, as a practical matter only private entities approved by the IRS as 501(c)(3)'s are also approved for JWOD program participation.) Under the proposed regulation, however, there could be a nonprofit (which is a qualified Section § 501(c)(3) organization for which the net income does not inure in whole or in part to the benefit of any shareholder or other individual, and yet the Committee could find the executive compensation exceeds the maximum benchmark and deny eligibility. In other words, the use of maximum benchmark in the proposed regulation does not inform the Committee about whether net income inures to the benefit of any shareholder or other individual (even with the other proposed factors considered). The maximum benchmark -- derived from a Federal salary -- has no bearing on whether the compensation is private inurement or fair consideration for services rendered. Its application could result in the rejection of a nonprofit from the program even though there is no private inurement as that term is use in the statute.

The Committee is not authorized to change the JWOD program eligibility criteria established by Congress so that a nonprofit that is eligible under the statute can be declared ineligible and disqualified by the Committee under the regulations. Congress has set very specific eligibility criteria for the program and it controls those criteria. This proposed ruled contravenes the will and intent of Congress and thus exceeds the statutory authority given to the Committee. As the U.S. Supreme Court has held:

> The power of an administrative [agency] to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law . . . but the power to adopt regulations to carry

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[7] IRC § 501(c)(3) states that certain organizations qualify as tax exempt nonprofits if "no part of the net earnings of which inures to the benefit of any private shareholder or individual." *See also, e.g.*, District of Columbia Nonprofit Corporation Act § 29-301.02; Kentucky Nonprofit Corporation Acts § 273.161; New Mexico Nonprofit Corporation Act § 53-8-2.C; New York Not-for-Profit Corporation Law § 102(a)(5); Texas Non-profit Corporation Act § 1396-2.24; and Virginia Nonstock Corporation Act § 13.1-814.

> into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity.

See, Legal Environmental Assistance Foundation, Inc. v. United States Environmental Protection Agency, 118 F.3d 1467, 1473 (11 Cir. 1997), *citing Dixon v. United States*, 381 U.S. 68, 74 (1965), *quoting Manhattan General Equipment Co. v. Commissioner*, 297 U.S. 129 (1936). There is nothing in the JWOD Act that gives the Committee the authority to regulate compensation paid to the executives of nonprofits participating in the JWOD program, much less in a manner which is so contrary to and out of harmony with the statute.

Additionally, the proposed rule exceeds the Committee's authority because it conflicts with another Federal statute – the Internal Revenue Code. An agency action which conflicts not only with the agency's own statute, but also conflicts with another federal law will be invalidated under the Administrative Procedure Act. 5 U.S.C. § 706(2). The D.C. Circuit has held:

> Under the Administrative Procedure Act, we must "hold unlawful and set aside agency action ... found to be ... not in accordance with law [or] ... in excess of statutory jurisdiction, authority, or limitations." 5 U.S.C. § 706(2). This provision requires us to invalidate agency action not only if it conflicts with any agency's own statute, but also if it conflicts with another federal law.

See, Scheduled Airlines Traffic Offices, Inc. v. Department of Defense, 87 F.3d 1356, 1361 (D.C. Cir. 1996) (applying 5 U.S.C. § 706(2)(A) and declaring a Department of Defense policy invalid under the Miscellaneous Receipts statute).

The Internal Revenue Code reflects a specific Congressional intention regarding the regulation of executive compensation paid by nonprofits. As noted above, JWOD private nonprofits must also be tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code. Both those sections contain a prohibition against private inurement. However, neither Section 501(c)(3) or the regulations thereunder includes a cap or ceiling on the amount of compensation that can be paid, or even a maximum benchmark against which the reasonableness of executive

compensation will be measured. Moreover, there is a specific statute, Section 4958 of the Internal Revenue Code, that governs the compensation of executives of Section 501(c)(3) and 501(c)(4) organizations, including JWOD nonprofits. Section 4958 imposes penalties on executives who receive excessive compensation. However, that provision, like Section 501(c)(3), does *not* place any cap or ceiling on the amount of compensation that can be received or set any firm benchmark of compensation which is presumed to be the maximum reasonable amount. Instead, the regulations under Section 4958 require that such compensation be reasonable, and define "reasonable compensation" as "the amount that would ordinarily be paid for like services by like enterprises (whether taxable or tax-exempt) under like circumstances." Accordingly, under the same statutory prohibition on private inurement that is applicable to JWOD nonprofits, Section 501(c)(3) organizations are required to take steps to ensure that compensation paid to executives is reasonable, but are not subject to any specific dollar limitations on what that compensation may be. The Committee's proposed rule will therefore directly conflict with these Internal Revenue Code provisions. Under the proposed regulations, executive compensation paid by a JWOD nonprofit could end up being found to be reasonable by the Internal Revenue Service and unreasonable by the Committee, thus putting the nonprofit in an untenable position. In the specific language of the Internal Revenue Code, Congress intended for the Internal Revenue Service to oversee the reasonableness of executive compensation paid by Section 501(c)(3) nonprofits to the exclusion of any other federal agency. It never intended to confer such authority on the Committee, and this kind of conflict was not anticipated in the statutes.[8]

Under the Administrative Procedure Act, 5 U.S.C. § 706, a court would strike down the proposed rule as being beyond the scope of the Committee's authority. *See,*

[8] Additionally, it is a general maxim of statutory interpretation that a statute of specific intention takes precedence over one of general intention. *See Morales v. Trans World Airlines*, 504 U.S. 374, 384 (1992); *Sierra Club-Black Hills Group v. United States Forest Serv.*, 259 F.3d 1281, 1287 (10th Cir.2001). For example, a more specific statute dealing explicitly with the issue of contracting priority for the operation of cafeterias on federal property, the Randolph-Sheppard Act, authorizing Secretary of Department of Education to secure the operation of cafeterias on federal property by blind licensees, was controlling as to granting of contract for military base's mess hall services, rather than the Javits-Wagner-O'Day Act. The Court held that the latter was simply a general federal procurement statute favoring commodities and services produced by nonprofit agencies for the blind and disabled. *NISH v. Cohen*, 247 F.3d 197 (4th Cir. 2001). The Internal Revenue Code provisions, however, specifically address the regulation of executive compensation.

Chevron U.S.A. Inc. v. Natural Resource Defense Council, Inc., 467 U.S. 837, 842-843 (1984). For all of the foregoing reasons, the Committee should revise the proposed regulation to remove the portion regarding the regulation of executive compensation.

(B) B. The Proposed Regulation is Arbitrary and Capricious and Not Reasonably Related to the Purposes of the JWOD Act

Even if an agency has not exceeded its statutory authority per se, courts will review an agency's interpretation to determine if the construction is permissible and reasonably related to the purposes of the enabling legislation, and whether any of the provisions of the regulation are framed in an arbitrary or capricious manner. *See, State of Md. v. Mathews,* 415 F. Supp. 1206 (D.D.C.1976). There is no rational basis for the proposed rule, that is, no rational connection between the facts found and the choice made. *Westlands Water Dist. v. U.S., Dept. of Interior, Bureau of Reclamation,* 805 F. Supp. 1503 (E.D.Cal.1992).

(1) The Committee's Construction of its Enabling Statute is Not Permissible

As discussed in Section A, Congress has set the eligibility criteria for the JWOD Program. An organization is eligible so long as, among other requirements, it is "organized under the laws or the United States or of any state" and its net income "does not inure in whole or in part to the benefit of any shareholder." 41 U.S.C. § 48(b). However, the proposed regulation changes and adds a new, standalone eligibility criterion -- that executive compensation must be below the maximum benchmark amount or it will be presumed unreasonable -- without regard to whether the net income inures to the benefit of any shareholder or individual or not. Thus, the Committee unlawfully and improperly proposes to alter the statutory eligibility criteria.

Additionally, the proposed regulation directly conflicts with the Internal Revenue Code provisions. *See* I.R.C. Sections 501(c)(3) and 4958.[9] Accordingly, it is not a proper construction and interpretation of the JWOD Act. Also, the Internal Revenue

[9] Moreover, Congress through the Senate Finance Committee, is currently looking into governance standards for nonprofits to provide for a counterpart to the Sarbanes Oxley standards applicable to public companies. JWOD nonprofits should and will be governed by the same standards that are developed for other nonprofits, including other nonprofits receiving Federal funds.

Code provisions, as specific statutes that address the matter of self-governance of nonprofits and executive compensation, take precedence over the JWOD Act, which has already been found to be a general procurement statute. *See Nish v. Cohen, supra.*

It would be a permissible construction of the statute for the rule to govern the extent to which executive compensation can be included in the prices charged to Federal customers under the JWOD program. (Prices of procurement list commodities and services are a proper subject for Committee regulation under the Act. 41 U.S.C. § 47.) There are other Federal procurement statutes relating to the allowability of executive compensation costs charged to the Government. *See* 41 U.S.C. § 256(e)(1)(p); 10 U.S.C. § 2324 (e)(1)(p); and 41 U.S.C. § 5435. These statutes and the implementing regulations govern and cap the amount of executive compensation that can be charged under Federal contracts. *See* 48 C.F.R. § 31.205-6(p). The cap is currently $432,851, inclusive of wages, salaries, bonuses, deferred compensation, and employer contributions to a defined contribution pension plan. (Unlike the proposed maximum benchmark amount, however, it does not include health benefits. 48 C.F.R. § 31.205-6(p)(2)(i).) However, it is not permissible for the Committee to regulate what a nonprofit can *pay* its executives.

(2) The proposed rule is not reasonably related to the purpose of the enabling legislation

The purpose of the JWOD Act is to provide vocational opportunities to severely disabled persons through Federal contracts. S. Rep. No. 93-908 (1974), *reprinted in* 1974 U.S.C.C.A.N. 3940, 3941. The rule does nothing to ensure that JWOD nonprofits operate for the benefit of disabled persons, or enhance such vocational opportunities. There is no logical connection between an arbitrary cap or maximum benchmark on executive compensation and protecting or advancing the interests of disabled persons. In fact, by treating JWOD contractors differently from all other for-profit and nonprofit contractors and grant recipients, the rule puts JWOD contractors at a competitive disadvantage in terms of their ability to attract and retain the most talented executives and thereby succeed in winning contracts and in creating jobs for disabled persons. JWOD agencies will become a kind of second class nonprofit that is not worthy of superior employees and leadership. Indeed, some nonprofits who could contribute greatly to the program may choose not to even apply in the first instance due to this arbitrary eligibility criterion.

(3) There is no rational connection between any fact findings and this rule

The proposed rule effectively rescinds the existing rules. Under the existing rules, qualified 501(c)(3) nonprofits who meet the other requirements of the statute are eligible for participation in the JWOD program. Under the proposed rule, such a qualified nonprofit's participation could be terminated if (and potentially solely because) its executive compensation exceeds the maximum benchmark. Where an agency's proposed new rules have the effect of rescinding original rules, the agency's rulemaking will be deemed arbitrary and capricious if it is not adequately supported. *Mineral Policy Center v. Gale Norton et al.*, 292 F. Supp. 30, 37-38 (D.D.C. 2003) *quoting Motor Vehicles Manufacturers Association of the United States, et al. v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 43 (1983) ("'an agency changing its course must supply a reasoned analysis' . . . An agency must therefore 'examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'"). There is no evidence that JWOD nonprofit executive salaries are in excess of industry norm and/or that there are excessive executive salaries being paid that have a detrimental impact on the creation of jobs for their disabled employees. In fact, the rationale for proposed rule itself cites only to "isolated instances" of alleged excessive compensation. 69 Fed. Reg. 65,395. Therefore, there is no rational connection between the fact findings and this rule.

In addition, no rational basis is given as to why JWODs should be treated so differently than other nonprofit Federal contractors. By setting the maximum benchmark amount so low, the Committee has also effectively capped the amount that can be charged to Federal Contracts. (Only the compensation actually paid would be a cost that could be charged to a contract or included in an indirect cost pool.) OMB Circular A-122, which governs the allowability of costs that can be charged to grants and contracts by nonprofits (see FAR § 31.702) does not contain any cap on executive compensation that can be charged. The compensation charged to the grant or contract need only be "reasonable for the actual personal services rendered rather than a distribution of earnings in excess of costs," and "comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved." OMB Circ. A-122, Att. B., § 8. Also, there is no rationale basis for such disparate treatment of JWOD contractors. There is no rationale basis given as to why the maximum benchmark in the proposed regulation <u>is less than one-half</u> the amount allowed to be charged under Federal contracts under FAR § 31.205-6(p).

Moreover, there is no rational basis whatsoever to tie nonprofit executive salaries to the compensation of Federal employees. The asserted basis to tie the cap to Federal employee salaries is that Federal funds are involved in the JWOD program. 69 Fed. Reg. 65,397. However, the involvement/payment of Federal funds to private contractors and grantees has *never* been a basis to regulate or cap the salaries *paid* to the executives of those entities; it has only been a basis to regulate or cap the salaries *charged to Federal contracts and grants*.[10] And, when the involvement/payment of Federal fund is the reason for capping what can be charged to a grant or contract, the cap is *never* based on a Federal executive salary.

There are hundreds and possibly thousands of nonprofits (*e.g.*, universities and research institutions) that receive Federal funds through grants, other awards, and Federal contracts. There is no cap on their executive salaries; rather there is only a cap on what can be charged to the grant or contract. *See* OMB Circulars A-122, Att. B, § 8.[11] Similarly, there are thousands of for-profit Federal contractors. There has never been a cap on what those entities can pay their executives under the Federal procurement laws. There has only been a cap on what those entities can charge the Federal Government. And that cap is based on the industry norm, *not* on Federal employee salaries. *See* 41 U.S.C. § 435 (OFPP sets the benchmark based on the median compensation provided to senior executives (the 5 most highly compensated) of all benchmark corporations (publicly owned U.S. corporations with sales in excess of $50 million).[12]

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[10] Central nonprofit agencies may be more akin to a Federal agency. They receive all their funds from the Federal Government and their task is to administer the JWOD program. They do not sell products or services to the Government. JWOD contractors on the other hand are nothing like the central nonprofits. They are usually charitable organizations with many funding sources, and, with respect to the JWOD program are Federal contractors which sell products and services to the Government and in that role are no different than other Federal contractors.

[11] Also, OMB Circular A-133 already establishes audit procedures for nonprofits receiving Federal funds under certain conditions. Federally-funded programs undergo these audits annually and they address such matters as compliance with applicable Federal laws and regulations as well as the terms of the funding vehicle and the propriety of costs being charged to the Federal program.

[12] The Committee itself, through its central nonprofit agencies, caps the indirect costs JWOD contractors can charge to JWOD contracts through their indirect rates such as their General and Administrative rates. Thus, the amount of executive compensation

Moreover, the regulation incorrectly characterizes its proposed governance standards as "common practice in nonprofit business communities." 69 Fed. Reg. 65,395. However, a number of the proposed standards are neither common practice nor even under consideration by other organizations that have oversight over Section 501(c)(3) organizations.[13] For example, the proposal to "[publish and make public] the minutes of Board, or other governing authority, meetings" is far from common practice in the nonprofit community. 69 Fed. Reg. 65,400. Nonprofits are not required by the IRS or the states in which they are incorporated to publish minutes of meetings of governing bodies. Even the Senate Finance Committee Discussion Draft pertaining to governance reforms and the BBB-Wise Giving Alliance "Standards for Charity Accountability" do not recommend such an action, despite making other, specific recommendations to increase transparency.[14] Much of a Board's internal deliberations likely pertains to activities unrelated to participation in the JWOD program and may contain confidential information (*e.g.*, trade secrets, discussions of employee performance or terminations, etc.). There is no rational basis for requiring the disclosure of this information, and in fact there are many valid reasons not to do so.

Likewise, a requirement that an organization implement an annual evaluation process for the Board is not required of nonprofits by the IRS or state authorities, nor is it under contemplation by the Senate Finance Committee or the BBB Wise-Giving Alliance. It is unclear who would be in a position to conduct such evaluations. In addition, directors are already governed by traditional duties of care and loyalty under state law, and remedies already exist for enforcing such duties. Therefore, this additional requirement -- not required by any other body with oversight of nonprofits -- does not reasonably relate to the Committee's authority to "carry out the purposes of sections 46 to 48c of the Act."

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that can be included in such indirect cost pools is already capped at very restrictive rates.

[13] The governance reforms contained in the proposed regulations exceed the scope of reforms either recommended or under consideration by other bodies including the Internal Revenue Service, the Senate Finance Committee and "watchdog" agencies such as the Better Business Bureau Wise Giving Alliance.

[14] Available at <www.finance.senate.gov/hearings/testimony/2004test/062204stfdis.pdf> and <www.give.org/standards/impguide03.pdf>, respectively.

In addition, while the requirement that a financial expert serve on the Board is something presently required of public companies under the provisions of the Sarbanes-Oxley Act ("SOX"),[15] it is not required of nonprofits. Even recent legislation enacted in California which pertains to governance matters did not extend this SOX provision to nonprofit organizations. Nonprofits often rely on professional advisors for their financial expertise and Directors are permitted to discharge their duty of care with respect to financial matters by relying on the expertise of such advisors. As with the above proposed standards, this standard is not necessary for good governance and requiring it does not rationally relate to the subject matter of Committee's rulemaking authority.

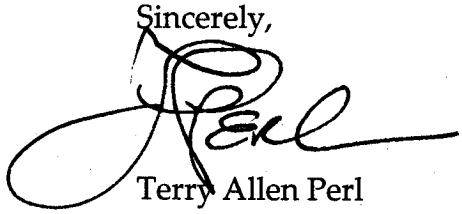
(C) Conclusion

For all of the foregoing reasons the Committee should substantially revise the proposed rule. At a minimum, there should be no fixed benchmark maximum amount of executive compensation that can be paid by nonprofit agencies. Assuming that the Committee even has the authority to regulate executive compensation paid (which it does not), the assessment of the reasonableness of the compensation should follow the IRS statutes and use a similar standard of reasonableness (e.g., "the amount that would ordinarily be paid for like services by like enterprises (whether taxable or tax exempt) under like circumstances"). In addition, compensation found reasonable by the IRS for a 501(c)(3) nonprofit agency should also be deemed reasonable by the Committee. There is no rational basis for determining that executive compensation found reasonable by the IRS is unreasonable for the JWOD program. Additionally, the use of the Federal salary as a benchmark for nonprofit agencies (other than the central nonprofits) is completely irrational on its face and should be removed. Furthermore, the Committee should give serious consideration to awaiting the outcome of the IRS and Senate Finance Committee's development of governance reforms so that JWOD nonprofits do not end up being at an unfair disadvantage because they are treated so differently from other all nonprofits.

[15] Section 407 of SOX, 15 U.S.C.A. § 7265.

Thank you for considering our comments regarding the proposed regulation.

Sincerely,



Terry Allen Perl
President and CEO